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Vice President
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EX PARTE OR LATE FILED

July 24, 1996

NYNEX

Ex Parte

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
Room 222
1919 M Street, N.W.
Washington, D.C. 20554

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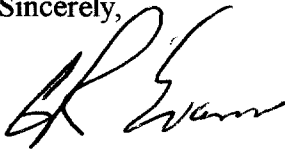
Federal Communications Commission
Office of the Secretary

RE: CC Docket 96-98

Dear Mr. Caton:

Yesterday, Mr. S. Fisher, Mr. R. Temple and I, representing NYNEX, met with Mr. W. Kennard, Mr. C. Wright, Mr. J. Olson and Ms. S. Tetreault of the General Counsel's Office. The purpose of the meeting was to discuss NYNEX's positions in this proceeding regarding the resale and unbundling requirements of the Telecommunications Act of 1996. The NYNEX representatives expressed their view that the Act does not contemplate requesting carriers to obtain from the incumbent local exchange carrier *all* the unbundled elements necessary for the provision of a telecommunications service. Rather, the unbundled network elements are for supplementing a carrier's existing facilities based network used in providing telecommunications services. During the course of the discussion, the attached legal memorandum was requested to be filed.

Sincerely,



attachment

cc: Mr. W. Kennard
Mr. J. Olson
Ms. S. Tetreault
Mr. C. Wright

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Legal Department

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Received by: [illegible]
Date: [illegible]

Date: April 29, 1996
To: File
From: D. Haraldson 
Subject: The Relationship of the Resale and the Unbundling Requirements of the Telecommunications Act of 1996

A. Summary

The Telecommunications Act of 1996 (the "Act") contains separate and distinct obligations regarding (i) the resale of services and (ii) access to unbundled network elements. Under the Act, deliberately different pricing methodologies apply to services offered for resale and network elements provided on an unbundled basis. A potential for conflict of these obligations arises where services offered for resale are made up of various network elements.

As discussed below, the legislative history and the express provisions of the Act show that the Act's resale obligations take precedence over the unbundling requirements. That is, a service that is offered for resale must be taken on a resale basis, subject to the pricing methodology that applies to services offered for resale. It would be inconsistent with the terms and purposes of the Act to permit an interconnector to evade resale requirements by purchasing all of the piece-parts of a service offered for resale as unbundled network elements. However, the priority of the Act's resale provision would

not preclude an interconnector from obtaining, on an unbundled basis, individual network elements or combinations of less-than-all of the network elements that compose a service offered for resale.

B. The History of the Act in the House and the Senate

The Act was originally introduced in the House as H.R. 1555.¹ H.R. 1555, as introduced, did not limit resale to services and unbundled access to network elements. Unbundling requirements applied to services, elements, features, functions, and capabilities. Resale requirements applied -- on both a bundled and an unbundled basis -- to services, elements, features, functions, and capabilities.²

H.R. 1555, as introduced, also failed to establish different pricing methodologies for unbundling and for resale. Users of unbundled services, elements, features, functions, and capabilities were required to bear the costs of providing

¹ H.R. 1555 As Introduced (May 3, 1995)

² H.R. 1555 As Introduced (May 3, 1995), § 242(a)(2) and (3):

“The duty under section 201(a) of a local exchange carrier includes the following duties: . . .

(2) UNBUNDLING OF NETWORK ELEMENTS. - The duty to offer unbundled services, elements, features, functions, and capabilities whenever technically feasible and economically reasonable, at just, reasonable, and nondiscriminatory prices and in accordance with subsection (b)(4).

(3) RESALE. - The duty not to prohibit, and not to impose unreasonable or discriminatory conditions or limitations on, the resale, on a bundled or unbundled basis, of services, elements, features, functions, and capabilities in conjunction with the furnishing of a telecommunications service or an information service.”

unbundled offerings.³ A separate pricing methodology for resale on a bundled basis was not addressed.

Shortly after it was introduced, certain amendments were proposed to the relevant sections of H.R. 1555. These amendments were included in the text of H.R. 1555, as reported by the House Subcommittee on Telecommunications and Finance.⁴ Among other things, the Subcommittee Text reframed the resale requirement of § 242(a)(3) as an affirmative duty, and a pricing methodology for resale was established. Specifically, the duties of LECs were amended to include the following:

RESALE. - The duty to offer services, elements, features, functions, and capabilities for resale at economically feasible rates to the reseller, recognizing pricing structures for telephone exchange service in such State, and the duty not to prohibit, and not to impose unreasonable or discriminatory conditions or limitations on, the resale, on a bundled or unbundled basis, of services, elements, features, functions, and capabilities in conjunction with the furnishing of a telecommunications service or an information service.”⁵

³ H.R. 1555 As Introduced (May 3, 1995), § 242(b)(4)(C):

“Within 15 months after the date of enactment of this part, the Commission shall complete all actions necessary (including any reconsideration) to establish regulations to implement the requirements of this section. . .

(C) USER PAYMENT OF UNBUNDLING COSTS. -

Such regulations shall require that the costs that a carrier incurs in offering unbundled services, elements, features, functions, and capabilities shall be borne by the users of such services, elements, features, functions, and capabilities ”

⁴ Text of H.R. 1555, as reported by the Subcommittee on Telecommunications and Finance (Committee Print) (May 20, 1995) (the “Subcommittee Text”).

⁵ Subcommittee Text, § 242(a)(3)(emphasis added). The following additional changes were also made: (i) the “economically reasonable” criterion was deleted from the

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The pricing methodology established for resale created controversy in the House. On May 24, 1995, Congressman Tauzin proposed an amendment that would have deleted the language in the Subcommittee Text that required resale "at economically feasible rates to the reseller, recognizing pricing structures for telephone exchange service in such State." In place of the foregoing language, Congressman Tauzin proposed to substitute the following: "at just and reasonable rates to the reseller."⁶ Although the proposed amendment was defeated, the controversy surrounding a resale pricing methodology continued.

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unbundling requirement of § 242(a)(2); and (ii) §245(b)(2) and (3) was changed to require a BOC to offer services, elements, features, functions, and capabilities for resale.

⁶ Tauzin Amendment Proposed May 24, 1995, to § 242(a)(3) of H.R. 1555. The proposed amendment also included the following proposed addition to the resale requirements:

"For purposes of this paragraph, it shall be deemed reasonable to limit the resale --

(A) of services included in the definition of universal service to a telecommunications carrier who intends to resell that service to a category of customers different from the category of customers being offered that universal service by such carrier if the Commission or State orders a carrier to provide the same service to different categories of customers at different prices necessary to promote universal service; or

(B) of subsidized universal service in a manner that allows companies to charge another carrier rates which reflect the actual cost of such services, exclusive of any universal service support received for providing such services."

The resale pricing methodology contained in the Subcommittee Text was included in the House Committee on Commerce Report 104-204, Part I.⁷ The House Report recognized resale as a vehicle to create immediate opportunities to compete “[i]n markets where a facilities-based competitor is not likely to emerge in the near term” The House Report stated the specific intent to set resale rates “by taking into account the rate at which local service is tariffed in a particular State.” The resale rates were to be determined in this manner to protect the subsidies of local dialtone service and universal service:

“Section 242(a)(3) imposes the duty to offer resale at economically feasible rates to the reseller. This duty is important in order for non-facilities-based carriers to have an opportunity to compete in the local exchange market, in the same way that it was critical initially for the early development of competition in the long distance market. In markets where a facilities-based competitor is not likely to emerge in the near term, the Committee believes that it is imperative that meaningful resale opportunities are available for competition in the local exchange.

Nonetheless, in determining the resale rate, it is the Committee’s intent that there be a recognition of pricing structures for telephone exchange service in the State. In other words, determining the resale rates should be accomplished by taking into account the rate at which local service is tariffed in a particular State. The rate should reflect whether, and to what extent, the local dialtone service is subsidized by other services, such as toll service, long distance access, subsidized through the pricing for other features, such as call forwarding and call waiting, or subsidized through explicit subsidies from a universal service fund.”⁸

⁷ House Committee on Commerce Report 104-204, Part I (July 24, 1995) (the “House Report”).

⁸ House Report, p. 72 (emphasis added).

The concern for the protection of subsidies of local telephone service and universal service is likewise reflected in a letter by four Congressmen, which is also included in the House Report.⁹ This letter refers to the requirement to offer resale at rates that are "economically feasible to the reseller" as the "most pernicious" restriction in H.R. 1555. The letter observes that local telephone service is heavily subsidized, and decries a resale pricing provision that would require prices to resellers that are further discounted. The legislators believed that any discount that exceeded the cost of marketing, and of billing and collection, would constitute an unwarranted subsidy to resellers and jeopardize universal service.

In order to address the concerns that had been voiced regarding local telephone service and universal service, Congressman Bliley proposed an amendment to § 242(a)(3) of H.R. 1555 that introduced the concept of resale at "wholesale rates", to be determined based on retail rates less avoided costs:

"(3) RESALE. - The duty -

(A) to offer services, elements, features, functions, and capabilities for resale at wholesale rates, and

(B) not to prohibit, and not to impose unreasonable or discriminatory conditions or limitations on, the resale of such services, elements, features, functions, and capabilities, on a bundled or unbundled basis, except that a carrier may prohibit a reseller that obtains at wholesale rates a service, element, feature, function, or capability that is available at retail only to a category of subscribers from offering such service, element, feature, function, or capability to a different category of subscribers.

For the purposes of this paragraph, wholesale rates shall be determined on the basis of retail rates for the service,

⁹ Letter signed by Congressmen Dingell, Tauzin, Boucher and Stupak, House Report, p. 209.

element, feature, function, or capability provided, excluding the portion thereof attributable to any marketing, billing, collection, and other costs that are avoided by the local exchange carrier.”¹⁰

The amendment was adopted. In the debates in the House, Congressman Dingell hailed the foregoing amendment as correcting a provision that would have required LECs to subsidize their competitors and “caused local rates to skyrocket for the household user.”¹¹

H.R. 1555, as passed by the House, included both resale and unbundling requirements. H.R. 1555 did not limit resale to services and unbundling to network elements. However, H.R. 1555 contained the resale pricing methodology proposed by Congressman Bliley, which provided for a wholesale price, determined on the basis of retail price, less avoided costs. Ultimately, this pricing methodology was adopted by Congress in the Act, and applied to the resale of telecommunications services. The development of this methodology was driven by the intent to provide wholesale vehicles to promote competition, while protecting local telephone service rates and universal service.¹²

¹⁰ Bliley Amendment proposed August 4, 1995:

¹¹ Congressional Record - House, August 4, 1995, H8452.

¹² The relevant provisions of H.R. 1555, as passed by the House, on October 12, 1995, are as follows:

§ 242(a)(2) and (3): “The duty under section 201(a) of a local exchange carrier includes the following duties: . . .

(2) UNBUNDLING OF NETWORK ELEMENTS. - The duty to offer unbundled services, elements, features, functions, and capabilities, whenever technically feasible, at just, reasonable, and nondiscriminatory prices and in accordance with subsection (b)(4).

(3) RESALE. - The duty -

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Similar concerns shaped the debate in the Senate concerning resale provisions. Like the House, the Senate did not distinguish two wholesale vehicles by limiting resale to services and unbundled access to network elements. However, as in the House, the resale pricing provisions were a source of controversy and the object of special concern.

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(A) to offer services, elements, features, functions, and capabilities for resale at wholesale rates, and

(B) not to prohibit, and not to impose unreasonable or discriminatory conditions or limitations on, the resale of such services, elements, features, functions, and capabilities, on a bundled or unbundled basis, except that a carrier may prohibit a reseller that obtains at wholesale rates a service, element, feature, function, or capability that is available at retail only to a category of subscribers from offering such service, element, feature, function, or capability to a different category of subscribers.

For the purposes of this paragraph, wholesale rates shall be determined on the basis of retail rates for the service, element, feature, function, or capability provided, excluding the portion thereof attributable to any marketing, billing, collection, and other costs that are avoided by the local exchange carrier.

§ 242(b)(4)(D): "Within 6 months after the date of enactment of this part, the Commission shall complete all actions necessary (including any reconsideration) to establish regulations to implement the requirements of this section. . . .

(D) USER PAYMENT OF COSTS. - Such regulations shall require that the costs that a carrier incurs in offering access, interconnection, number portability, or unbundled services, elements, features, functions, and capabilities shall be borne by the users of such access, interconnection, number portability, or services, elements, features, functions, and capabilities."

In S. 652, as introduced, unbundling requirements applied to "network functions and services" and certain facilities and information. Resale of unbundled "telecommunications services and network functions" was required.¹³ It appears that a

¹³ S.652 as Introduced and as Contained in the Report of the Committee on Commerce, Science, and Transportation (March 30, 1995), §251(b)(1), (2) and (7):

"MINIMUM STANDARDS -- An interconnection agreement entered into under this section shall, if requested by a telecommunications carrier requesting interconnection, provide for --

(1) nondiscriminatory access on an unbundled basis to the network functions and services of the local exchange carrier's telecommunications network (including switching software);

(2) nondiscriminatory access on an unbundled basis to any of the local exchange carrier's telecommunications facilities and information, including databases and signaling, necessary to the transmission and routing of any telephone exchange service or exchange access service and the interoperability of both carriers' networks; . . .

(7) telecommunications services and network functions of the local exchange carrier to be available to the telecommunications carrier on an unbundled basis without any unreasonable conditions on the resale or sharing of those services or functions, including the origination, transport, and termination of such telecommunications services, other than reasonable conditions required by a State; and for purposes of this paragraph it is not an unreasonable condition for a State to limit the resale --

(A) of services included in the definition of universal service to a telecommunications carrier who resells that service to a category of customers different from the category of customers being offered that universal service by such carrier if the State orders a carrier to provide the same service to different categories of customers at different prices necessary to promote universal service; or

(B) of subsidized universal service in a manner that allows companies to charge another carrier rates which reflect the actual cost of such services, exclusive of any universal service support received for providing such services"

cost-based pricing methodology was to apply to both unbundling and resale, subject to certain rights of the State in the case of universal service.¹⁴

The cost methodology to be applied to resale was the subject of an amendment proposed by Senators Stevens and Inouye. Their amendment would have required unbundled telecommunications services and network functions to be provided, without restriction on resale, at charges "based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the unbundled element, non-discriminatory, individually-priced to the smallest element that is technically feasible

¹⁴ S.652 as Introduced and as Contained in the Report of the Committee on Commerce, Science, and Transportation (March 30, 1995), § 251(d)(6):

"CHARGES -- If the amount charged by a local exchange carrier, or class of local exchange carriers, for an unbundled element of the interconnection provided under subsection (b) is determined by arbitration or intervention under this subsection, then the charge--

(A) shall be

- (i) based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the unbundled element;
- (ii) nondiscriminatory; and
- (iii) individually priced to the smallest elements that is technically and economically reasonable to provide; and

(B) may include a reasonable profit.

In the course of the Senate debates, Senator Hollings stated his interpretation that the cost-based pricing methodology of §251(d)(6) applied to interconnection and charges for each unbundled element provided under §255. He purported to rely on a reference to §251, contained in §255(b)(1). The effect of this interpretation would be to require interconnection and unbundling pursuant to the "competitive checklist" to be provided based on cost. This would presumably apply to resale as well, since §255 of S.652 then provided for resale of unbundled telecommunications services and network functions.

and economically reasonable to provide and based on providing a reasonable profit to the Bell operating company.”¹⁵

It was clearly intended that resale prices should be set to protect existing subsidies. Senator Inouye stated that resale prices should be based on the actual cost of provided services and functions, and reflect “the very substantial savings” resulting from selling on a wholesale basis. He went on to clarify, however, that subsidies of residential retail rates would be “counted towards the recovery of costs in setting resale prices.”¹⁶

Unlike the House, the Senate was not able to resolve the issue of resale pricing. In withdrawing the Stevens-Inouye amendment, Senator Stevens stated that the issue of resale pricing would be resolved in the conference reconciling H.R. 1555 and S. 652.¹⁷ The relevant provisions of S.652 were passed by the Senate in substantially the same form in which they had been introduced.¹⁸

¹⁵ Congressional Record - Senate, June 14, 1995, S8400.

¹⁶ Congressional Record-Senate, June 14, 1995, S8369.

¹⁷ Congressional Record - Senate, June 15, 1995, S8438.

¹⁸ The relevant provisions of S. 652, as passed by the Senate, are as follows:

§ 251(b)(1)(2) and (7): “MINIMUM STANDARDS. -- An interconnection agreement entered into under this section shall, if requested by a telecommunications carrier requesting interconnection, provide for --

(1) nondiscriminatory access on an unbundled basis to the network functions and services of the local exchange carrier’s telecommunications network (including switching software, to the extent defined in implementing regulations by the Commission);

(2) nondiscriminatory access on an unbundled basis to any of the local exchange carrier’s telecommunications facilities and information, including databases and signaling, necessary to the transmission and routing of any telephone exchange service or

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exchange access service and the interoperability of both carriers' networks . . .

(7) telecommunications services and network functions of the local exchange carrier to be available to the telecommunications carrier on an unbundled basis without any unreasonable conditions on the resale or sharing of those services or functions, including the origination, transport, and termination of such telecommunications services, other than reasonable conditions required by a State; and for purposes of this paragraph, it is not an unreasonable condition for a State to limit the resale --

(A) of services included in the definition of universal service to a telecommunications carrier who resells that service to a category of customers different from the category of customers being offered that universal service by such carrier if the State orders a carrier to provide the same service to different categories of customers at different prices necessary to promote universal service; or

(B) of subsidized universal service in a manner that allows companies to charge another carrier rates which reflect the actual cost of providing those services to that carrier, exclusive of any universal service support received for providing such services in accordance with section 214(d)(5)"

§ 251(d)(6): "CHARGES. -- If the amount charged by a local exchange carrier, or class of local exchange carriers, for an unbundled element of the interconnection provided under subsection (b) is determined by arbitration or intervention under this subsection, then the charge --

(A) shall be -

- (i) based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the unbundled element,
- (ii) nondiscriminatory, and
- (iii) individually priced to the smallest element that is technically feasible and economically reasonable to provide; and

(B) may include a reasonable profit."

C. The Two Distinct Wholesale Vehicles, with Different Pricing Methodologies, Created by the Act

The Act defines and distinguishes bundled “telecommunications services” and the unbundled “network elements” that compose them.¹⁹ The Act requires that telecommunications services and network elements each be offered at wholesale in a distinctly different way. Telecommunications services are to be offered for resale, as provided by the Act. Each local exchange carrier (“LEC”) has “[t]he duty not to prohibit, and not to impose unreasonable or discriminatory conditions or limitations on, the resale of its telecommunications services.”²⁰ In addition, an incumbent LEC has the duty “to offer for resale at wholesale rates any telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers” No prohibitions, or unreasonable or discriminatory conditions or limitations, may be imposed on resale, except that a State may prohibit resale to a different class of customers of a telecommunications service obtained at wholesale which is available at retail only to a particular class of customers.²¹

¹⁹ Under §3(51) of the Act, telecommunications service means “the offering of telecommunications for a fee directly to the public, or to such classes of users as to be effectively available directly to the public, regardless of the facilities used”. Network element, by comparison, is defined in §3(45) of the Act as “a facility or equipment used in the provision of a telecommunications service. Such term also includes features, functions, and capabilities that are provided by means of such facility or equipment, including subscriber numbers, databases, signaling systems, and information sufficient for billing and collection or used in the transmission, routing, or other provision of a telecommunications service.”

²⁰ Act §251(b)(1).

²¹ Act §251(c)(4).

In the case of network elements, an incumbent LEC has the following duty:

“[T]o provide, to any requesting telecommunications carrier for the provision of a telecommunications service, nondiscriminatory access to network elements on an unbundled basis at any technically feasible point on rates, terms, and conditions that are just, reasonable and nondiscriminatory in accordance with the terms and conditions of the agreement and the requirements of [section 251] and section 252. An incumbent local exchange carrier shall provide such unbundled network elements in a manner that allows requesting carriers to combine such elements in order to provide such telecommunications service.”²²

Markedly different pricing methodologies apply to resale of services and unbundled network elements. A “top down” approach applies to resale of services; while a “bottom up” approach applies to unbundled network elements. Section 251(c)(4) requires an Incumbent LEC to offer services for resale at “wholesale rates.” Wholesale rates are to be determined “on the basis of retail rates charged to subscribers for the telecommunications service requested, excluding the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided by the local exchange carrier.”²³ By contrast, charges for unbundled network elements: “(A) shall be - (i) based on the cost (determined without reference to a rate-of-return or other rate-based

²² Act §251(c)(3). The distinction between resale of services and access to unbundled network elements also appears in the “competitive checklist,” which must be met by a Bell Operating Company (a “BOC”) in order to obtain in-region interLATA relief. Checklist items include: “Telecommunications services are available for resale in accordance with the requirements of sections 251(c)(4) and 252(d)(3)”;²³ and “Nondiscriminatory access to network elements in accordance with the requirements of sections 251(c)(3) and 252(d)(1).” Act §271(c)(2)(B)(ii) and (xiv).

²³ Act §252(d)(3).

proceeding) of providing the interconnection or network element (whichever is applicable), and (ii) nondiscriminatory, and (B) may include a reasonable profit.”²⁴

D. The Priority of Resale Provisions over Unbundling Requirements

Congress acted deliberately to develop the distinctions between the two wholesale tracks -- (i) resale of services, at retail less avoided costs and (ii) unbundling of network elements, at cost and including a reasonable profit. Ultimately, Congress adopted resale provisions that limit the resale obligation of Incumbent LECS to services offered at retail to non-carrier subscribers, and require Incumbent LECS to offer those services for resale at rates determined based on retail less avoided costs.²⁵

The resale pricing methodology is in sharp contrast to the pricing methodology that Congress chose to apply to unbundled network elements, which provides for prices based on cost, and including a reasonable profit.²⁶ In fact, the resale pricing provisions are a clear rejection of cost-based rates. This is consistent with the history of other provisions of the Act, which shows that Congress did not intend §§251 and 252 as catalysts for rate rebalancing.²⁷ Rather the intent was to use resale to “jump

²⁴ Act §252(d)(1).

²⁵ Act §§251(c)(4) and 252(d)(3).

²⁶ Act §252(d)(1).

²⁷ Sections 251 and 252 do not contain any provisions that would require rebalancing of rates. This is consistent with the legislative history, which evidences a rejection of rate rebalancing, or an intent to defer that issue to a consideration of universal service as prescribed in §254. Section 248 of H.R. 1555 contained provisions which would have minimized residential price increases; §301 of S.652 included a provision related to price regulation and consumer protection which, like H.R. 1555 §248, is inconsistent with the rebalancing of rates through the closer alignment of prices with costs. Although these

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start" competition, while protecting local telephone service and universal service through the "top down" resale pricing methodology of retail, less avoided costs.

This carefully crafted and clearly expressed plan would be defeated -- and the deliberate creation of two distinct wholesale vehicles would be abrogated -- if the unbundling requirements were allowed to subsume the resale provisions. This would inevitably occur if interconnectors could evade the resale pricing methodology prescribed by the Act by purchasing, at cost, all of the network elements making up a service offered for resale. The only way the Act can be construed to give full effect to its express terms and the intent of Congress is to conclude that the resale provisions of the Act take precedence over the unbundling requirements.²⁸ Accordingly, a service offered for resale

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provisions were not included in the Act, they are indicative of Congress' deeper concern to protect consumers from increased rates than to achieve cost-based rates at the expense of existing subsidies. Notwithstanding the fact that charges for interexchange access contain large subsidies, the final legislation does not include provisions which were in both the House and Senate bills that would have required BOCs to provide exchange access at cost-based rates. See H.R. 1555 §246(i)(3) and S.652 §252(e)(3). In fact, §251(g) of the Act expressly preserves the status quo with regard to charges for interexchange access.

²⁸ The last sentence of §251(c)(3) -- regarding the combining of network elements -- does not support a conclusion that resale provisions of the Act may be evaded by combining an incumbent LEC's network elements to duplicate a service offered for resale. To the contrary, Congress intended that facilities-based or partially facilities-based interconnectors would supplement their own facilities with network elements obtained from the incumbent to enable the interconnector to combine its facilities with the incumbent's network elements in order to provide the interconnector's competing, facilities-based services to its customers. Given the context and the legislative history, this sentence cannot be construed to permit an interconnector to obtain the network elements at cost-based prices for the purpose of reassembling the network elements to form a service offered for resale.

pursuant to §251 must be purchased on a resale basis, subject to the pricing methodology that applies to services offered for resale.